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The Undivided Fee Rule in California

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THE UNDIVIDED FEE RULE IN CALIFORNIA

When land is condemned under the power of eminent domain the owner or owners of such land are entitled to just compensation.[1] Measured in terms of money, just compensation is usually taken to be the market value of such land.[2] Market value is a question of fact[3] determined by evaluating the testimony of various experts regarding the price a willing buyer would pay a willing seller if both parties were aware of all the relevant facts about the land.[4] One of the major problems facing the court in a condemnation proceeding is to ascertain which facts are relevant to the determination of market value and which are not.

One of the more troublesome of the potentially critical facts is the rental value of the condemned property when it is encumbered with a leasehold estate. There is a substantial conflict in the California cases as well as in the cases of other states as to how this fact should be treated.

The basic question is whether the market value of the condemned land should be determined by aggregating the interests of the separate owners,[5] or by viewing the land as an unencumbered, undivided fee.[6] In theory at least, the total sum paid by the condemnor, and apportioned among the holders of the various interests,[7] should be

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[1] U.S. CONST. amend. V. Similar provisions are found in most of the state constitutions. *See, e.g.*, CAL. CONST. art. I, § 14.

[2] *See* National City Bank v. United States, 275 F. 855, 859 (S.D.N.Y. 1921); 4 P. NICHOLS, THE LAW OF EMINENT DOMAIN §§ 12.2, 12.2(1) (rev. 3d ed. 1962).

[3] Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 13, 62 Cal. Rptr. 113, 119 (1967).

[4] Sacramento S.R.R. v. Heilbron, 156 Cal. 408, 409, 104 P. 979, 980 (1909); Redevelopment Agency v. Zwerman, 240 Cal. App. 2d 70, 74-75, 49 Cal. Rptr. 443, 446 (1966); Daly City v. Smith, 110 Cal. App. 2d 524, 531, 243 P.2d 46, 50 (1952).

[5] This method is referred to as the *aggregate of interests rule.* For a statement of this rule by a California court, see Sacramento Drainage Dist. v. Truslow, 125 Cal. App. 2d 478, 489, 270 P.2d 928, 935 (1954). *See also* Federal Oil Co. v. Culver City, 179 Cal. App. 2d 93, 98-100, 3 Cal. Rptr. 519, 522-23 (1960).

[6] This method is referred to as the *undivided fee rule.* For a statement and application of this rule by a California court, see People *ex rel.* Department of Pub. Works v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 298 P.2d 53 (1956).

[7] This is true, at least, in California. *See* Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 4, 13, 62 Cal. Rptr. 113, 119 (1967); CAL. CODE CIV. PROC. § 1248(1).

the same in either case.[8] In practice, however, the two rules for determining market value have taken on substantive variations, resulting in different amounts being awarded to the condemnees in certain situations.[9] The difference between the two rules for determining market valuation is that they stem from two apparently irreconcilable theories.[10]

The theory behind the undivided fee rule, which has long been the majority rule,[11] is that a condemnation proceeding is an action in rem against a parcel of land.[12] On the other hand, the aggregate of interests rule is founded upon the constitutionally guaranteed right of a landowner to be compensated when his property is taken for a public use.[13]

The prevalence of the undivided fee rule can be explained in terms of the courts' desire for simplicity and practicality,[14] in that: First, the value of the unencumbered land usually equals, or approximates, the aggregate of the separate interests;[15] secondly, much ef-

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[8] For a discussion of some of the difficulties that arise in making this assumption, see Polasky, *The Condemnation of Leasehold Interests*, 48 VA. L. REV. 477, 490-93 (1962).

[9] *See, e.g.*, Baltimore v. Latrobe, 101 Md. 621, 630-31, 61 A. 203, 206 (1905).

[10] *See* Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596 (1954).

[11] People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 875, 62 Cal. Rptr. 320, 324 (1967); 2 J. LEWIS, A TREATISE ON THE LAW OF EMINENT DOMAIN § 716 (3d ed. 1909); 4 P. NICHOLS, THE LAW OF EMINENT DOMAIN, § 12.36 (rev. 3d ed. 1962); 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 109, at 461 (2d ed. 1953).

[12] *See, e.g.*, Eagle Lake Improvement Co. v. United States, 160 F.2d 182, 184 (5th Cir. 1947); Reeves v. Dallas, 195 S.W.2d 575, 581-82 (Tex. Ct. App. 1946).

[13] *See* Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910); Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596, 615-20 (1954). It is interesting to note that when the aggregate of interests rule has been adopted on the basis of the owner's right to compensation, the courts have said that the undivided fee rule is based upon the theory that the measure of compensation should be the taker's gain. *See, e.g.*, Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910). On the other hand, when the undivided fee rule has been adopted, the theoretical justification for its use was the in rem nature of the condemnation proceeding, while the alternative aggregate of interests rule was said to be based upon the theory that the taking was of a cluster of rights that together amount to ownership. *See, e.g.*, Eagle Lake Improvement Co. v. United States, 160 F.2d 182, 184 (5th Cir. 1947). This failure of the courts which adopt either the undivided fee rule or the aggregate of interests rule to reject specifically the theory on which the alternative rule is actually based provides a good illustration of the conceptual difficulties encountered in this branch of the law of eminent domain.

[14] *See* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN, § 109 (2d ed. 1953).

[15] *Id.* § 112, at 480.

fort is saved in separating the practical question of value from the often legally complex question of apportionment;[16] and thirdly, it is much easier for the condemnor to estimate in advance the necessary monetary outlay for an unencumbered fee.[17]

The purpose of this note is to explicate the use and nonuse of the undivided fee rule in California. An understanding of the law in California is impossible, however, without first recognizing the substantive implications that arise when the undivided fee rule is applied in two fact situations.

The Inconsistent Results of the Undivided Fee Rule

There are two situations in which the total compensation for the condemnation of leasehold-encumbered land will vary depending upon whether the undivided fee rule or the aggregate of interests rule is applied.[18]

Disparity Between Rental Income and Market Level

The first situation is that in which a lessor receives from his property either a greater or lesser rental income than the current market level. When neither the lessor nor the lessee has an inflated or deflated interest, the market value of the lessee's interest is zero and there is no problem in awarding compensation.[19] If rental income is less than the market level, the lessor's interest is deflated while the lessee's is inflated.[20] If the rental income exceeds the market level, however, the lessor's interest is inflated while the lessee's is deflated.[21] It is in this latter situation that valuation problems arise.

Because the lessor's interest will usually retain some market value despite a disadvantageous lease, there is no difficulty in awarding a lessee the inflated amount of his lease by reducing the lessor's share of the award.[22] The problem arises when the lessor's interest is inflated and the lessee's deflated. Since the lessee's interest is value-

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[16] St. Louis v. Rossi, 333 Mo. 1092, 1104, 64 S.W.2d 600, 605 (1933).

[17] *See* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 109 (2d ed. 1953).

[18] The two situations about to be discussed are not exhaustive, but they are particularly relevant to the use and nonuse of the undivided fee rule in California. For other situations in which the use or nonuse of the undivided fee rule has substantive implications, see 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN §§ 107, 108 (2d ed. 1953).

[19] *See* Polasky, *The Condemnation of Leasehold Interests*, 48 VA. L. REV. 477, 490-91 (1962).

[20] *Id.*

[21] *Id.*

[22] *See* Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 12, 62 Cal. Rptr. 113, 118 (1967); People *ex rel.* Department of Pub. Works v. Los Angeles, 220 Cal. App. 345, 33 Cal. Rptr. 797, 808-09 (1963).

less, it cannot absorb the loss occasioned by the excess value that is due the lessor. When the undivided fee rule or the aggregate of all the owner's interests rule is applied, the results are the same and no difficulty is encountered. When, however, only those owner's interests which have a market value are included in the computation of the condemnation award, excluding the deflated interest of the lessee, then the lessee is unjustly enriched at the expense of either the lessor or the condemnor. Application of the undivided fee rule would result in the unjust enrichment of the lessee at the expense of the lessor, as the lessor loses the above market value of his lease. Under the aggregate of the interests rule, the lessee is again unjustly enriched but at the expense of the taxpayer as the condemnor pays the inflated value of the lease to the lessor but receives only the lower fair market value of the land.

Land Encumbered With a Restrictive Lease

The second fact situation in which the use or nonuse of the undivided fee rule has substantive implications is where the lessee is restrained by the terms of the lease from using the land in the best and most profitable manner, and there is no corresponding pecuniary advantage to the lessor.

In this type of situation it cannot be said that either party has an over- or undervalued interest. The discrepancy in the total amount of compensation awarded for the condemned land that results from the use or nonuse of the undivided fee rule arises only from the disuse of the land and not from an inflated or deflated valuation of the lessor's or lessee's interest. The result is that a choice must be made between a policy favoring the owners, or one favoring the condemnor. Application of the undivided fee rule frees the lessor and lessee from the restrictive lease and pays them more than their interests would be worth on the open market.[23] On the other hand, use of the aggregate of the interests rule results in payment of the market value of the owners' respective interests, thereby unjustly enriching the condemnor, as the fair market value of the land would be more than the total amount of compensation paid.[24]

Where the lessee's interest is deflated, as in the first fact situation, the issue is whether the lessor or the condemnor should bear the burden of the lessee's deflated interest. Application of the undivided fee rule favors the condemnee in this case. Where the land is not used in its highest and most profitable manner, as in the second fact situation, the issue is whether the lessor or the condemnor should be enriched. Application of the undivided fee rule in this case favors the

[23] The rule is employed in this manner in People *ex rel.* Department of Pub. Works v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 298 P.2d 53 (1956).

[24] This is the approach taken in Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910).

lessor. It should be obvious that even if one felt justified in declaring either the rights of the lessor or the rights of the public as paramount,[25] nevertheless, strict adherence to either one rule or the other precludes a consistent result. Each rule favors the lessor in one situation and the condemnor in the other. It remains to be seen how California treats the conflict between these rules.

The Undivided Fee Rule in California

California statutes, as well as court decisions, appear to support both the undivided fee and the aggregate of interests rules. Section 1246.1 of the California Code of Civil Procedure gives the condemnor the right to have the value of the land determined as a whole, after which it is apportioned among the interest holders.[26] On the other hand, Code of Civil Procedure section 1248(1) requires that each interest in the condemned land be valued separately and each owner be given the value of his interest.[27] California Evidence Code section 817 provides that existing leases or rents are a proper element to be considered in fixing the market value of the land,[28] whereas Evidence Code section 812 indicates that section 817 is not to be construed as

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[25] Inferentially, at least, a judgment which favors the public is made whenever the value of the undivided fee is taken to be the upper limit of compensation. On the other hand, it is arguable that whenever the concept of indemnity is employed (*e.g.*, when severance damages are awarded) the court has presupposed the segregation of two issues: First, the paramount right of the public to take the property; and second, the paramount right of the condemnee to be compensated.

[26] CAL. CODE CIV. PROC. § 1246.1: "Where there are two or more estates or divided interests in property sought to be condemned, the plaintiff is entitled to have the amount of the award for said property first determined as between plaintiff and all defendants claiming any interest therein; thereafter in the same proceeding the respective rights of such defendants in and to the award shall be determined by the court, jury, or referee and the award apportioned accordingly. The costs of determining the apportionment of the award shall be allowed to the defendants and taxed against the plaintiff except that the costs of determining any issue as to title between two or more defendants shall be borne by the defendants in such proportion as the court may direct."

[27] CAL. CODE CIV. PROC. § 1248: "The court, jury, or referee must hear such legal testimony as may be offered by any of the parties to the proceedings, and thereupon must ascertain and assess . . . [t]he value of the property sought to be condemned, and all improvements thereon pertaining to the realty, and of each and every separate estate or interest therein; if it consists of different parcels, the value of each parcel and each estate or interest therein shall be separately assessed. . . ."

[28] CAL. EVIDENCE CODE § 817: "When relevant to the determination of the value of property, a witness may take into account as a basis for his opinion the rent reserved and other terms and circumstances of any lease which included the property or property interest being valued or any part thereof which was in effect within a reasonable time before or after the date of valuation."

affecting substantive law on the subject.[29]

In sum, California statutory law embraces neither the undivided fee rule nor the aggregate of interests rule. It should not be inferred, however, that the code provisions are inconsistent. Although Code of Civil Procedure section 1248(1) calls for separate valuation of separate interests, it does not exclude the possibility of dividing up a fund calculated on the basis of an undivided fee. Moreover, even though section 1246.1 of the Code of Civil Procedure calls for an evaluation of the fee as a whole, this evaluation need not rest on the premise that the fee is an unencumbered whole. As declared in *People ex rel. Department of Public Works v. Lynbar, Inc.*:[30]

> The fact that in this situation, by resorting to section 1246.1, the condemnor can force the valuation award against it to be a single sum for the entire fee . . . does not compel the conclusion as a corollary to this requirement that the total fee so valued must of necessity be valued as if it were owned only by one owner, when in fact it is actually owned jointly by more than one owner.[31]

The California Supreme Court has not directly decided whether the undivided fee or the aggregate of the interests rule should be applied where the lessee's interest has no market value, or where the highest and best use of the land is restricted by the terms of the lease. The few decisions that approach the problem seem to contain elements of both positions, and have supplied dicta that can be used to support either rule.[32] Consequently, the appellate courts have been left free to adopt or to denounce the undivided fee rule. They have done both. For example, the Second District Appellate Court, in *People ex rel. Department of Public Works v. Lynbard, Inc.*,[33] denounced the undivided fee rule,[34] while five days later, the appellate court for the Fourth District adopted it.[35]

The Search for a New Rule: The Lynbar Case

The California case law concerning the undivided fee rule can best be analyzed by first looking at the *Lynbar* decision since, while it is misleading, it does present the most comprehensive analysis of the problem. The defendant, Lynbar, Inc., leased real property to

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[29] CAL. EVIDENCE CODE § 812: "This article is not intended to alter or change the existing substantive law, whether statutory or decisional, interpreting "just compensation" as used in Section 14 of Article I of the State Constitution or the terms "value," "damage," or "benefits" as used in Section 1248 of the Code of Civil Procedure."

[30] 253 Cal. App. 2d 870, 62 Cal. Rptr. 320 (1967).

[31] *Id.* at 879, 62 Cal. Rptr. at 327.

[32] *See, e.g.*, People *ex rel.* Department of Pub. Works v. Thompson, 43 Cal. 2d 13, 23, 271 P.2d 507, 513 (1954); Los Angeles v. Klinker, 219 Cal. 198, 211, 25 P.2d 826, 832 (1933).

[33] 253 Cal. App. 2d 870, 62 Cal. Rptr. 320 (1967).

[34] *Id.* at 882, 62 Cal. Rptr. at 328-29.

[35] Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 11, 62 Cal. Rptr. 113, 117 (1967).

Tide Water Realty Company[36] for 20 years at a minimum rental of $725 per month. At the date of valuation, the lease had 17 years and 10 months to run. Prior to the execution of the lease, and until the date of valuation, the property was the site of a retail service station. The condemnee's sole valuation witness estimated the fair market value of the property at $180,000, giving full consideration to the Tidewater lease. The condemnor's two valuation witnesses, without consideration of Tidewater's lease, estimated the fair market value of the property at $55,000 and $52,000, respectively. The same two witnesses, considering the leasehold value, estimated the property's market value at $89,475 and $125,000, respectively. Thereafter, the parties stipulated in open court that the fair market value of the property was $125,000, subject to the condemnor's right to attack the method of valuation on appeal.

The condemnors argued on appeal that Code of Civil Procedure section 1246.1 required that the determination of the fair market value of the property be grounded on the premise that the property was held in single undivided ownership despite the existence of a lease favorable to the lessor at the date of valuation. The condemnees, on the other hand, argued that in view of the California Supreme Court decision in *People ex rel. Department of Public Works v. Dunn*[37] and Evidence Code section 817, it was proper to consider existing rental income on the condemned property. The appellate court accepted the conclusion of the condemnees but rejected the reasoning of both parties, concluding that Code of Civil Procedure section 1246.1 was purely procedural,[38] that Evidence Code section 817 was not only procedural but had not yet become effective when the case was tried,[39] and that the *Dunn* case was inconclusive.[40]

Rather than adopt the arguments of either party, the court posed the question, "of what does the whole really consist, for which payment is to be made by the condemnor in one lump sum under section 1246.1, if it so elects?"[41] The *Lynbar* court answered the question by affirming the holding of the trial court and thereby compensated the lessor for his inflated interest.

Of the propositions advanced in support of the court's holding, three merit considerable attention. First, the basis of compensation should be what the owner has lost, not what the taker has gained.[42]

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[36] Between the trial and the appeal of the *Lynbar* case Tide Water Realty Co. transferred all its assets, including its interest in the property involved in this case, to the Tidewater Oil Co. *See* 253 Cal. App. 2d at 873 n.1, 62 Cal. Rptr. at 323 n.1. The lease will hereinafter be referred to as the "Tidewater" lease.

[37] 46 Cal. 2d 639, 297 P.2d 964 (1956).

[38] People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 878, 62 Cal. Rptr. 320, 326 (1967).

[39] *Id.* at 877, 62 Cal. Rptr. at 325.

[40] *Id.* at 876-77, 62 Cal. Rptr. at 325.

[41] *Id.* at 879, 62 Cal. Rptr. at 327.

[42] *Id.* at 882, 62 Cal. Rptr. at 329.

Secondly, the fair market value of the land taken should be determined by consideration of, among other things, the condition in which the land was taken, including the existing lease.[43] Thirdly, while the undivided fee rule is the majority rule, it is not the rule in California.[44]

Compensation Based on What the Owner Has Lost

The first justification of the holding in *Lynbar* is that compensation should be based on what the owner has lost. This justification fails to support the *Lynbar* holding for two reasons: First, the cases relied upon in *Lynbar* to support the idea that the owner's loss should be the measure of compensation contain such distinct fact situations that they are not compelling authority in the fact situation presented in *Lynbar*. Second, the per curiam opinion denying a rehearing of the *Lynbar* case indicates that the court was confused about the theory on which it meant to base compensation.

The absence of compelling authority is most evident in the *Lynbar* court's reliance upon *Boston Chamber of Commerce v. Boston*.[45] In *Boston*, Mr. Justice Holmes' opinion, quoted in the *Lynbar* case,[46] held that the controlling question was "[W]hat has the owner lost, not what has the taker gained."[47] The *Boston* case, however, involved the condemnation of land encumbered with an easement of passage. It is well settled that the market value of an easement is based on the diminution in the value of land to which the easement is appurtenant[48] because the easement has no market value (*i.e.*, cannot be sold) apart from the dominant estate.[49] Since the owner's loss is merely different terminology for the diminution in value of the dominant estate, it is fair to conclude that the peculiarity of easements appurtenant compelled the use of the owner's loss as the measure of compensation in the *Boston* case. Because the *Lynbar* case does not involve the condemnation of easements, the *Boston* case does not logically compel the use of the owner's loss as a measure of compensation in *Lynbar*.

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[43] *Id.* at 881, 62 Cal. Rptr. at 328.

[44] *Id.* at 878, 62 Cal. Rptr. at 326.

[45] 217 U.S. 189 (1910).

[46] 253 Cal. App. 2d at 882, 62 Cal. Rptr. at 329.

[47] 217 U.S. 189, 195 (1910).

[48] Hemmerling v. Tomlev, Inc., 67 Cal. 2d 572, 575, 432 P.2d 697, 699, 63 Cal. Rptr. 1, 3 (1967); People *ex rel.* Department of Pub. Works v. Logan, 198 Cal. App. 2d 581, 586, 17 Cal. Rptr. 674, 677 (1961).

[49] 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 107, at 455 (2d ed. 1953). The irrelevancy of the market value of the servient, condemned estate is well demonstrated by the inverse condemnation action in Smith v. San Diego, 252 Cal. App. 2d 438, 442-43, 60 Cal. Rptr. 602, 605 (1967), where the complainant failed even to describe in the complaint the property interest taken—an easement. The complainant was given leave to amend, but the point was well made that the claim was for damage to the remaining parcel.

None of the other cases used in the *Lynbar* opinion as authority for using the owner's loss as the measure of compensation involved the condemnation of divided interests.[50] This is a critical variation from the facts in *Lynbar* because to talk of what *the* owner (singular) has lost when there are divided interests is either nonsense (there being more than one owner by definition), or the assumption has already been made that the interest of one of the owners is to be excluded from the computation of compensation. It is apparent, therefore, that the use of the owner's loss as a measure of compensation when there is only one owner not only fails to compel the use of that measure in *Lynbar*, where there was more than one owner, but involves concepts which are analytically unrelated.

Not only do the cases relied upon by *Lynbar* appear to be less than compelling authority, but also, the per curiam opinion denying a petition for rehearing the *Lynbar* case indicates either that the court was confused about the owner's loss theory or that it knowingly rejected the theory of compensation based on the owner's loss and advanced a new rule that conflicts with well-settled California law. In the per curiam opinion it is said:

> If the actual rent under the existing lease is above the fair rental value of the parcel taken, ordinarily the fair market value of that parcel will be enhanced and the condemnor must pay more for it by way of compensation. If, on the other hand, the actual rental under the existing lease is less than such fair rental value, ordinarily the fair market value . . . will be reduced accordingly and the condemnor pays less. . . .[51]

It can easily be inferred from this language that when the lessee is paying less than the fair rental value he would not be entitled to the "bonus value" or market value of his leasehold estate. To deprive the lessee of the market value of his lease, however, is unquestionably inconsistent with California law.[52] Furthermore, it would make no sense to require, as does California Code of Civil Procedure section 1248(1),[53] an apportionment of the total award among the various owners if it is assumed from the outset that the lessee, one of the owners, is not entitled to the market value of his lease. It is doubtful that the court in *Lynbar* meant to advocate the result that the loss incurred by the lessee-owner would not be compensated, and the actual holding in *Lynbar*, as well as the court's justification for that holding, is that an owner's loss should be compensated. It is, therefore, much more likely that the suggestion in the per curiam opinion reflects the court's complete misunderstanding of the correct applica-

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[50] *See* Los Angeles v. Faus, 48 Cal. 2d 672, 312 P.2d 680 (1957); People v. La Macchia, 41 Cal. 2d 738, 264 P.2d 15 (1953).

[51] People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 884, 62 Cal. Rptr. 320, 330 (1967).

[52] *See, e.g.*, Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 62 Cal. Rptr. 113 (1967); Budaef v. Huber, 194 Cal. App. 2d 12, 14 Cal. Rptr. 729 (1961).

[53] See note 27 *supra*.

tion of the theory of compensation based on the owner's loss.

The missing link in *Lynbar* court's reasoning was a justification for excluding from the computation of compensation the interest of the lessee, one of the two owners. Since this exclusion was a vital step in fixing the amount of compensation in *Lynbar*, to presuppose this exclusion by talking of the loss of *one* owner when there are *two* owners is a critical error. It necessarily precludes the possibility of justifying the *Lynbar* holding either on the basis of those authorities that adopt the owner's loss as the measure of compensation, or on the supposition that a new rule was being advocated. It is therefore suggested that the *Lynbar* court's first justification for its holding fails, in fact, to support that holding.

Compensation That Accounts For The Land's Divided Ownership

The second proposition advanced in *Lynbar* is, as stated by the court, that: "[T]he property, together with all of its compensable attributes, must be valued as the condemnor finds it, including without limitation thereby, the state of its title, and in this case, the Tidewater leasehold."[54] The court appears to be suggesting that the total award to be apportioned should include the value of all contractual rights that affect the ownership of the condemned land. In other words, the holding in *Lynbar*, in effect, compensated directly for the lessor's right to receive rental income without particular reference to the market value of the land itself.

If this proposition were meant in its broadest sense, however, the result in *Lynbar* would have been different. Full consideration of the contractual relationships existing at the time of the condemnation would have resulted in an arrangement whereby the condemnor would have been subrogated to the rights of the lessor against the lessee. An analogous result was achieved in *In re Braddock Avenue*.[55]

In the *Braddock* case, the New York court awarded the mortgagee compensation based on the value of the unencumbered fee, while holding that the fee owners were entitled only to nominal damages based on a valuation of the encumbered fee. This unique method of compensation arose because, after the mortgagee had acquired his interest in the property, the mortgagor subjected the property to certain easements without the consent of the mortgagee. Since the mortgagee's rights were not limited by the easements, he was entitled to an award equaling the value of the property without consideration of the easements. To avoid unjustly enriching the mortgagor by reducing the mortgage indebtedness, the court held that the condemnor should be subrogated to the rights of the mortgagee against the mort-

[54] People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 881, 62 Cal. Rptr. 320, 328 (1967).

[55] *In re* Braddock Avenue, 278 N.Y. 163, 15 N.E.2d 563 (1938). *See also* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 111, at 473-74 & n.31 (2d ed. 1953) (discussion of *Braddock* and subsequent difficulties).

gagor's remaining property.[56]

Since the *Lynbar* case did not reach a result analogous to *Braddock*, it is apparent that the concept envisioned by the *Lynbar* court was narrower than the proposition adopted by the *Braddock* court: That compensation should be based on all contractual relationships, even if a party who has an interest in the land condemned must actually pay a sum of money to one of the other parties. Whether broad or narrow, however, it would be inconsistent with California law to include in the *total* award all contractual relationships that affect the ownership of the land.[57] The weight of authority in California is that the fair market value of the condemned land is to be determined without reference to contractual rights and obligations affecting the land.[58] It is therefore suggested that the second proposition advanced by the court in *Lynbar* in support of its holding fails to be persuasive.

The Application of the Undivided Fee Rule in California

The *Lynbar* court's final proposition is that while the undivided fee rule is the majority rule, it is not the rule in California. The California courts have rarely had occasion to discuss the undivided fee rule, undoubtedly because the use or nonuse of the rule rarely has substantive implications.[59] Of the four California cases that have discussed the rule, however, only the *Lynbar* decision has held the undivided fee rule inapplicable,[60] and the other three decisions have expressly espoused the rule. The *Lynbar* case dismissed the treat-

[56] 278 N.Y. 163, 174, 15 N.E.2d 563, 566 (1938).

[57] In People *ex rel.* Department of Pub. Works v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 298 P.2d 53 (1956), relied upon by the condemnors in *Lynbar*, the condemned land was subject to oil and gas leases, and at least one of the lessees was unwilling to surrender his surface rights to the land. Nonetheless, the court held that the leases were not a factor to be considered in determining the availability of the land for its highest and best use.

In El Monte School Dist. v. Wilkins, 177 Cal. App. 2d 47, 1 Cal. Rptr. 715 (1960), also relied upon by the condemnors in *Lynbar*, the condemned land was not only encumbered with leaseholds, but between the lessors and lessees the structures on the land were personalty so far as the right of removal was concerned. Nonetheless, for purposes of valuation, the lessees' contractual right of removal was disregarded and between the condemnor and the condemnees the structures were considered as part of the realty.

In Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 62 Cal. Rptr. 113 (1967), the existence of an exploration and development lease was disregarded in computing the value of the land taken. *See* People *ex rel.* Department of Pub. Works v. Los Angeles, 220 Cal. App. 2d 345, 33 Cal. Rptr. 797 (1963).

[58] See note 57 *supra.*

[59] *See* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 112, at 480 (2d ed. 1953).

[60] *See* People *ex rel.* Department of Pub. Works v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 107, 298 P.2d 53, 55 (1956).

ment of the rule in *El Monte School District v. Wilkins*[61] as dictum,[62] and said it was unnecessary[63] in *People ex rel. Department of Public Works v. S. & E. Homebuilders, Inc.*[64] No doubt the espousal of the rule in *Costa Mesa Union School District v. Security First National Bank*[65] would also have been dismissed as dictum or unnecessary if the case had been decided prior to *Lynbar*.[66]

The purpose of the following analysis of these cases, *i.e.*, *Wilkins*, *S. & E. Homebuilders* and *Costa Mesa*, is to establish two propositions: First, the undivided fee rule was essential to the holding in each of the three cases; and secondly, that when the use of the undivided fee rule favors the condemnee, that rule should be used.

In *Wilkins*, the court considered as realty those structures which were, between the lessors and lessees, personalty. One of the questions on appeal was whether, in the apportionment phase of the trial, the lessees had received adequate compensation. After the jury had returned its verdict fixing the market value of the whole property, the lower court found that the compensation due to each of the lessees was equivalent to the removal value of the structures. It is apparent that to have the jury determine the market value of the land without reference to the value of the lessees' interests—which could only be considered if the structures were regarded as personalty—and then to have the court determine the compensation due the lessees independently of, and without reference to, the total sum to be awarded, logically permits the adoption of only one theory, the undivided fee rule. The appellate court upheld that method of compensation. Thus, despite the *Lynbar* court's statement that approval of the undivided fee rule in this case was dictum, the actual use of the rule was an essential presupposition underlying the appellate court's holding.

The undivided fee rule was also used by the court as a justification for regarding the lessees' personalty as realty in the condemnation action. Since this was not an issue on appeal, it needed no justification. The statement of the rule therefore, actually was unnecessary. It was important, nonetheless, as a statement of policy.

It is not hard to imagine a case similar to *Wilkins* in which the structures that belonged to the lessee substantially increase the value of the realty as a whole, but because the lessee has the right of removal, and because such removal would largely destroy the value of the structures, the structures add little or nothing to the value of either the lessor's or lessee's interest considered separately. Professor Nichols, in his work on eminent domain,[67] poses this problem and

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61 177 Cal. App. 2d 47, 1 Cal. Rptr. 715 (1960).

62 People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 877, 62 Cal. Rptr. 320, 326 (1967).

63 *Id.* at 878, 62 Cal. Rptr. at 326.

64 142 Cal. App. 2d 105, 298 P.2d 53 (1956).

65 254 Cal. App. 2d 4, 62 Cal. Rptr. 113 (1967).

66 The *Costa Mesa* case was decided five days after the *Lynbar* decision.

67 P. NICHOLS, THE LAW OF EMINENT DOMAIN (rev. 3d ed. 1962).

then concludes:

> If the condemnor has to pay the whole additional value of the real estate due to the existence of the buildings and fixtures, either the landlord or the tenant will receive more than his interest is worth. Whether this is one of the cases in which the value of the real estate as such is disregarded and the total value of the separate interests in the real estate is the proper measure of compensation is not yet entirely clear.[68]

The fact situation hypothesized here is quite analogous to the situation referred to previously where a restrictive lease prevented the property from being used in the highest and most profitable manner, in that the total value of the lessor's and lessee's interests is less than the undivided fair market value of the property. It was there indicated that the use of the undivided fee rule would yield a result favorable to the condemnees, and the result would be the same in the present hypothetical. Although Professor Nichols expressed doubt about the propriety of using the undivided fee rule in the present hypothetical, the court in *Wilkins* had no such doubts. Unlike the above stated hypothetical, the structures owned by the lessees in *Wilkins* added nothing to the value of the realty as a whole.[69] Nonetheless, there is no reason to suspect that the court would not have approved of the undivided fee rule if the facts had corresponded with the much more likely hypothetical, since the only party that could possibly have suffered in *Wilkins* was the lessor, and yet it was the lessee that was appealing.

It may be concluded therefore, that *Wilkins* supplies some authority for the proposition that when the undivided fee rule works to the advantage of the condemnees, that rule should be used.

In *Costa Mesa* the declaration of the undivided fee rule appears even more like dictum than in *Wilkins*. Although the use or nonuse of the rule was not the question on appeal, the adequacy of the lessee's compensation was again the issue. On appeal it was held that after the total award has been determined, the interest of the leaseholder must then be determined, even though that interest played no part in the determination of the total award. By so deciding, the court implicitly affirmed the use of the undivided fee rule.

As in *Wilkins*, the espousal of the undivided fee rule has a broader significance in *Costa Mesa* than would appear at first glance. The rule was used as a justification for disregarding an extremely restrictive exploration and development lease in determining the value of the land as a whole. The appellate report did not reveal, however, whether the restrictions upon the lessee resulted in any actual disuse of the rented property, and the facts indicate that any restrictions upon the lessee's use of the land might have been offset to some extent, at least, by the lessor's retained right to use the land for agricultural purposes. Assuming, however, that there was some disuse of the land, this case corresponds perfectly to the situation earlier re-

[68] 4 *id.* § 13.121(1), at 375.

[69] 177 Cal. App. 2d at 54, 1 Cal. Rptr. at 720.

ferred to involving a restrictive lease, and thus, the use of the undivided fee rule would be advantageous to the condemnees. Consequently, *Costa Mesa* adds some support to the proposition advanced above, that when the undivided fee rule favors the condemnees, the rule should be used.

In *S. & E. Homebuilders*, the court quoted and approved the following portion of respondent's brief:

> [T]here is not one California decision, which extensive research has developed, to the effect that it is proper to say that a property such as here, immediately usable, legally and practically, for industrial subdivision purposes, is not 'available' therefor because of *private contractual* agreement existing *between* two of the *co-owners* of interest in such property in an action where the condemning body seeks to acquire the fee simple estate.[70]

The court concluded that it was not error for the trial court to instruct the jury that "the parcel in question was to be valued as if owned by one person, regardless of the separate interests therein."[71] It is clear, therefore, that the question on appeal was whether the undivided fee rule should be used, and that the appellate court affirmed its use.

The court in *Lynbar* dismissed the use of the undivided fee rule in *S. & E. Homebuilders* as unnecessary on the ground that the leases were "totally inoperative." This argument, however, is not only a non sequitur, but is also without factual support. It is true that the two lessees had not utilized their surface rights in connection with their oil and gas rights, and one of the lessees had offered to cooperate with the lessor in the industrial development of the land. The net effect of the leasing arrangement, however, was that the land was not being used. Furthermore, the lessees had refused to quitclaim their rights to the surface, and the estimated life of the leases was 14 years. There is no way to circumvent the fact that the lessees had legal, compensable interests in the land, and that, because of the consequent disuse of the land, the case corresponds to the situation referred to above where a restrictive lease prevented the property from being used in the highest and most profitable manner. Moreover, the appraisers were not indifferent to the effect of the lessees' rights upon the market value of the land. The three expert witnesses for the condemnees, without consideration of the restrictive leases, estimated the market value of the land to be, respectively, $184,350, $211,636, and $191,156. The three expert witnesses for the state, with full consideration of the restrictive leases, estimated the market value of the land to be, respectively, $53,048, $50,600, and $55,634. On cross examination, one of the state's expert witnesses admitted that if the restrictive leases were not considered, and if the land had been in single ownership, the full value would have been $87,939. It is apparent, therefore, that the existence or non-existence of the leases, re-

[70] People *ex rel.* Department of Pub. Works v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 107, 298 P.2d 53, 55 (1956).

[71] *Id.* at 109, 298 P.2d at 55.

gardless of whether they were operative or not, was the critical factor. Given the existence of the leases, and the consequent rights of the lessees, the use of the undivided fee rule would result in a substantially larger award than an aggregation of the values of the owners' respective interests. In fact, the jury's award, using the undivided fee rule, was $111,930, which was more than twice the value placed upon the land by those witnesses who took account of the restrictive leases.

It may be concluded, therefore, that the *S. & E. Homebuilders* case provides direct and persuasive support for the proposition that the undivided fee rule will be used when its use favors the condemnees. It follows from the qualified support for this proposition found in both the *Wilkins* case and the *Costa Mesa* case that all of the cases that adopt the undivided fee rule in California are consistent with a policy that favors the condemnee. This policy is also consistent with the ruling in *Lynbar*, for the net effect of the holding in *Lynbar* is that the undivided fee rule should not be used when it works to the disadvantage of the condemnee. Thus, the California rule emerges: If one party is to be enriched, let it be the condemnee, and if one party must suffer a loss, let it be the condemnor.

The Undivided Fee Rule Is Not the California Rule

Notwithstanding the preceeding discussion, it could be argued that the undivided fee rule is still the general rule in California, and that the *Lynbar* case is only an exception to the general rule or, alternatively, that the *Lynbar* decision can actually be reconciled with the undivided fee rule.

Possible Reconciliation

The argument for the reconciliation of the undivided fee rule with *Lynbar* is based upon the holding in *People ex rel. Department of Public Works v. Dunn*,[72] and the later codification of that holding in Evidence Code section 817,[73] *i.e.*, that actual rentals are a proper consideration in determining the market value of the property as a whole.[74] Even though the *Lynbar* court expressly refused to base its decision upon the *Dunn* case,[75] it could be argued that *Dunn* did, in reality, justify the *Lynbar* decision, and that both *Dunn* and *Lynbar* are consistent with the undivided fee rule.

This reconciliation can be best explained by noting the words of the Missouri Supreme Court in *St. Louis v. Rossi*,[76] a case often cited

[72] 46 Cal. 2d 639, 297 P.2d 964 (1956).

[73] *See* People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 876, 62 Cal. Rptr. 320, 325 (1967).

[74] 46 Cal. 2d at 641, 297 P.2d at 966.

[75] People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 876, 62 Cal. Rptr. 320, 325 (1967).

[76] 333 Mo. 1092, 64 S.W.2d 600 (1933).

for its classic opinion in support of the undivided fee rule. The Missouri court declared: "It is, of course, true that a favorable lease does increase the value of property and that the amount of income which is derived from property is always properly considered in determining its value."[77] The point is that actual income derived from property is usually a more reliable index to the property's market value than is speculative income. The experts who estimate the condemned property's market value are not in any way limited to a consideration of actual rentals, but neither are they precluded from inspecting them. The *Dunn* case and Evidence Code section 817 require that evidence of actual rentals be considered. *St. Louis v. Rossi* endorsed this procedure as an adjunct to the undivided fee rule, and such evidence was actually considered in *S. & E. Homebuilders*, the leading California case applying the undivided fee rule.

If it be remembered that the choice in *Lynbar* was between "taking into account" the Tidewater lease or completely disregarding it, the court's adherence to the first alternative would seem entirely consistent with the undivided fee rule. The three estimates that did take the lease into account—$89,475, $125,000, and $180,000—especially when compared with the estimates that disregarded the lease, speak loudly for the proposition that when a jury is confronted with both the undivided fee rule and a lease very favorable to the lessor it will have ample opportunity to reward the lessor for the bargain he has made. Upon this analysis, which takes due notice of the flexibility inherent in jury awards of compensation, it could be expected that if a jury in the *Lynbar* case had been instructed in accordance with the undivided fee rule, and if the same evidence respecting actual rental income had been allowed, the jury would have returned an award quite similar to the actual award in *Lynbar*.[78]

Thus, the *Dunn* case, although decided before either *S. & E. Homebuilders* or *Lynbar*, effects a possible reconciliation between the undivided fee rule and *Lynbar*. Perhaps this is why the supreme court, which decided the *Dunn* case, denied hearings to both *S. & E. Homebuilders* and *Lynbar*. But it is better to conclude otherwise for the reconciliation is only superficial. Essential to the reconciliation is the obvious ambiguity respecting the meaning of "taking into account" existing rental income. The academic dishonesty in perpetuating this ambiguity could perhaps be accepted as part of California law were it not that the problem is more serious. Such a reconciliation forces either the court or the jury to behave unconscionably. In the *S. & E. Homebuilders* case, testimony was allowed estimating the market value of the land encumbered with the leases, and yet the jury returned a verdict more than twice as large as any of these estimates.[79]

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[77] *Id.* at 1106, 64 S.W.2d at 606.

[78] Such a reconciliation has at least been implicitly suggested. *See* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 112, at 480 (2d ed. 1953).

[79] See text accompanying note 71 *supra*.

In *Lynbar*, testimony was allowed estimating the market value of the undivided fee, and yet the court affirmed an award that was more than twice the size of any of those estimates.

It is therefore apparent that to reconcile *Lynbar* with the undivided fee rule on the strength of *Dunn* is unjustifiable. The holding in *Dunn* should be limited to the ordinary case of divided interests where actual rental income might really be an accurate index to the land's market value.[80] *S. & E. Homebuilders* and *Lynbar* were not ordinary cases of divided interests; the problems and solutions involved were unique, and if the cases are reconcilable it is only on a policy basis.

Lynbar As An Exception to the General Rule

It was suggested earlier that the argument could be made that since it has always been well recognized that there are exceptions to the undivided fee rule,[81] *Lynbar* can be classified as such an exception. If the undivided fee rule is the general rule in California, it is a general rule with unusual consequences; and if the *Lynbar* case is an exception to the general rule, it is an exception with unusual consequences.

As already mentioned,[82] the theory behind the undivided fee rule is that a condemnation proceeding is an action in rem. No less significant as a corollary of the undivided fee rule is the often stated principle that the sum of the separate values of the divided interests may not exceed the value of the whole.[83] Clearly, by this principle, the value of the undivided fee is the upper limit of compensation. This principle is consistent with both the normal application of the undivided fee rule, and the normal exception to the rule—when the result obtained would be a substantially smaller award for the condemnees by application of the aggregate of the interests rule.[84] A few cases have suggested that if the sum of the interests exceeded the value of the undivided whole, the award should be based on the sum of the interests.[85] These cases, however, are doubtful authority.[86] Although

80 *See generally* Polasky, *The Condemnation of Leasehold Interests*, 48 VA. L. REV. 477, 490 (1962).

81 People *ex rel.* Department of Pub. Works v. Lynbar, Inc., 253 Cal. App. 2d 870, 875-76, 62 Cal. Rptr. 320, 325 (1967); 4 P. NICHOLS, THE LAW OF EMINENT DOMAIN § 12.2 (rev. 3d ed. 1962).

82 See text accompanying note 12 *supra*.

83 *See, e.g.*, United States v. 25.936 Acres of Land, 153 F.2d 277, 279 (3d Cir. 1946); St. Louis v. Rossi, 333 Mo. 1092, 1102-03, 64 S.W.2d 600, 604-05 (1933). *See also* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 109, at 461-62 (2d ed. 1953).

84 *See, e.g.*, Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910); Baltimore v. United States, 147 F.2d 786, 789 (4th Cir. 1945).

85 *See* Baltimore v. Latrobe, 101 Md. 621, 631, 61 A. 203, 205-06 (1905); State *ex rel.* McCaskill v. Hall, 325 Mo. 165, 172, 28 S.W.2d 80, 82 (1930).

86 The same court that decided State *ex rel.* McCaskill v. Hall, 325 Mo.

case reports are inadequate to reach a positive conclusion,[87] in light of the principle stated above, it is doubtful that the undivided fee rule has ever been employed to obtain a substantially larger award than would be obtained by aggregating the interests.

In California, on the other hand, in every case where the undivided fee rule has been specifically accepted, its use would result in a potentially larger award for the condemnees.[88] Similarly, on the only occasion where the rule is denounced, in *Lynbar*, its use would result in a reduced award to the condemnees.[89] Thus, where the undivided fee rule would normally be applied, California invokes the exception, and where the exception to the rule would normally be invoked, California applies the rule. The value of the undivided fee thereby forms the lower, rather than the upper, limit of compensation in California. Consequently, to classify *Lynbar* as an exception to the generally accepted undivided fee rule is to reject the thrust of the above stated California rule, and would appear to be unjustified.

Conclusion

The thesis argued in this note is quite narrow in scope. It involves only two types of factual situations. In one situation, either the condemnor or the condemnees would be enriched by the condemnation; California resolved the issue by invoking the undivided fee rule to the ultimate advantage of the condemnees. In the other situation, either the condemnor or the condemnee would suffer a loss because of the condemnation; California resolved that issue by denouncing the undivided fee rule, again to the ultimate advantage of the condemnee.

In those instances where the use or nonuse of the undivided fee rule has substantive implications, California follows the unique and laudable course of adopting whichever rule will favor the condemnee. Whether this policy will be followed in other areas of the law of eminent domain remains to be seen. In any event, a frank admission of the policy behind the use or nonuse of the undivided fee rule would do much to eliminate the confusion that plagues this area of the law.

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165, 28 S.W.2d 80 (1930), strongly endorsed the undivided fee rule three years later in St. Louis v. Rossi, 333 Mo. 1092, 64 S.W.2d 600 (1933). At the same time, the court questioned the holding in Baltimore v. Latrobe, 101 Md. 621, 61 A. 203 (1905).

[87] *See* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN § 110, at 465 (2d ed. 1953).

[88] See text accompanying notes 61-71 *supra*.

[89] The *Lynbar* case contains the only explicit denunciation of the rule by a California court. The aggregate of interests rule has been used in other California cases, but never with the effect of causing the lessor to suffer an arbitrary loss. *See* Federal Oil Co. v. Culver City, 179 Cal. App. 2d 93, 98-100, 3 Cal. Rptr. 519, 522-23 (1960); Sacramento & San Joaquin Drainage Dist. v. Truslow, 125 Cal. App. 2d 478, 489, 270 P.2d 928, 935 (1954).

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